INDEX

CITATIONS

766555—47

In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 408

TRUST UNDER AGREEMENT DATED DECEMBER 30, 1921, BY JOHN E. ANDRUS, DECEASED (TRUST No. 1), CENTRAL HANOVER BANK AND TRUST COMPANY, HAMLIN F. ANDRUS, and WILLIAM H. TAYLOR, TRUSTEES, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The Opinion of the Tax Court (R. 3–13) is reported at 7 T. C. 573. The opinion of the Circuit Court of Appeals (R. 15–20) is reported at 163 F. 2d 208.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 24, 1947. (R. 23.) The petition for a writ of certiorari was filed on Octo-

ber 20, 1947. The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether Section 22 (a) of the Internal Revenue Code includes in a taxpayer's gross income the percentage of long-term capital gain not required by Section 117 (b) to be taken into account in computing net income.

STATUTES AND REGULATIONS INVOLVED

The applicable provisions of the statute and regulations involved are set forth in the Appendix, *infra*, pp. 10–14.

STATEMENT

This case was submitted on a stipulation of facts (R. 13–14) together with documentary evidence; the Tax Court found the facts as stipulated (R. 3–5).

The taxpayers are the trustees under a trust agreement executed by John E. Andrus, since deceased, dated December 30, 1921. The trust was to continue during the lives of two designated persons and, during that time, the income of the trust was to be distributed in accordance with the provisions of the trust instrument. At the death of the survivor of these individuals, the corpus of the trust was to be distributed. (R. 3–4).

The trust agreement provided, among other things, that the trustees were to pay forty-five

percent of the trust's net income (computed in accordance with the provisions of the trust) to the Surdna Foundation, Inc. The balance of the income of the trust was to be distributed among a number of beneficiaries whose incomes were subject to income tax. (R. 4.)

The Surdna Foundation, Inc., is a New York corporation organized for exclusively charitable purposes. Under the provisions of the trust agreement forty-five percent of the trust's net income for the year 1941 was paid or permanently set aside for the Surdna Foundation, Inc. (R. 4.)

During the year 1941, the long-term capital gain from assets held more than twenty-four months was $87,406.39. The long-term capital loss from assets held more than eighteen months but not more than twenty-four months was $2,461.25. Income other than capital gains was $16,769.39. Deductions other than contributions totaled $19,224.01. The total net long-term capital gain was $84,945.14. The net income of the trust prior to deductions for contributions was $82,490.52. (R. 5.)

In the income tax return for 1941, the taxpayers computed the excess of gross income over deductions to be $92,087.59 and claimed as a deduction for income set aside for Surdna Foundation, Inc., forty-five percent thereof, or $41,439.42. The taxpayers agreed before the Tax Court that the income of the trust after payment

of expenses was $82,490.52 and claimed as a deduction for income set aside for Surdna Foundation, Inc., forty-five percent of this amount or $37,120.74. (R. 5.)

The Commissioner determined a deficiency in income tax for the year 1941 in the amount of $5,691.90. This resulted, in part, from his determination that a portion of the amount set aside for the Surdna Foundation, Inc., could not be deducted in full under Section 162 (a) of the Internal Revenue Code on the ground that it was not made entirely out of the gross income of the trust. The taxpayers, on the other hand, claimed an overpayment of income tax. (R. 5–6.)

The Tax Court ruled that the payment in question was deductible in full and, accordingly, that there had been an overpayment of tax in the amount of $115.71. (R. 5–13.) The Circuit Court of Appeals reversed, holding with the Commissioner that the taxpayer had gross income only to the extent that its capital gains were required by Section 117 (b) to be taken into account in the computations of its net income and that its charitable deduction must be limited to the amount which came from its gross income. (R. 15–20.)

ARGUMENT

1. The decision below is correct and is based on a proper interpretation of the statutory provisions involved. The pivotal issue on which the

case turns is whether the gross income of a trust under Section 22 (a) of the Internal Revenue Code, (Appendix, *infra*), includes the percentage of long-term capital gains which is not required to be taken into account in the computation of net income under Section 117 (b) of the Internal Revenue Code, (Appendix, *infra*). If, as the court below held, Congress did not intend that gross income under Section 22 (a) should include the percentage of capital gains which, in effect, are ignored by Section 117, it is not disputed that the decision on the ultimate question is correct, namely, that the amount deductible by the taxpayer for charitable contributions under Section 162 (a), (Appendix, *infra*), must be limited to the payments which came from its gross income (calculated without reference to the percentage of long-term capital gain not taken into account in the computation of its net income). (Pet. 6.) Indeed, Section 162 (a) is clear that, to the extent that charitable payments do not come out of gross income, no deduction may be had. *Frank Trust of 1931* v. *Commissioner,* 145 F. 2d 411 (C. C. A. 3d).[1]

[1] Section 162 (a) provides that the deduction is to be "without limitation." As the court below pointed out (R. 19–20), this phrase serves to distinguish the deduction for trusts from that for individuals which is limited to fifteen per cent of net income under Section 23 (o). It is not disputed that the court below was correct in its view that the "without limitation" clause does not permit the trust to take a deduction to the extent that payments do not come out of its gross income.

The provisions of Section 117, its legislative history, and the scheme of the entire statutory pattern confirm the court below in its construction of the statutory provisions. The device of taxing capital gains by taking only a specified percentage into account in computing the tax (depending on the length of time the asset is held) dates from the adoption of Section 117 of the Revenue Act of 1934, c. 277, 47 Stat. 680. The committee reports are clear to the effect that a taxpayer would include in "gross income" only the percentage of capital gain to be taken into account in the computation of net income and that a taxpayer was considered as measuring his "gain" only to the extent that the capital gain was required to be taken into account. H. Rep. No. 704, 73d Cong., 2d Sess., pp. 10, 31–32 (1939-1 Cum. Bull. (Part 2) 554, 562, 578); S. Rep. No. 558, 73d Cong., 2d Sess., pp. 11–13 (1939–1 Cum. Bull. (Part 2) 586, 594–596). The very definition in Section 117 (a) (4) of the Internal Revenue Code shows that the measure of the "gain" is the extent to which it is required to be taken into account under Section 117 (b). To the extent that capital gains are not so measured, there are no "gains" under Section 22 (a). Further, "net income" under Section 21 (Appendix, *infra*) is defined as gross income under Section 22 less the deductions permitted by Section 23 (Appendix, *infra*). Since Section 23 does not grant

a deduction for the percentage of capital gains not taken into account under Section 117, it is manifest that this portion of the gains must be excluded under Section 22 (a) in order that there may be an exclusion from net income under Section 21. The deduction under Section 23 (g) (1) for capital losses (to the extent taken into account) is a necessary one for, under the statutory pattern, there is no other way of reducing net income on account of such losses. (See Pet. 7.) The same is not true of gains, for here Section 22 (a), by excluding the portion not taken into account, accomplishes the purpose desired by Congress.

2. The decision below, in its construction of Sections 22 (a) and 117, is the first judicial determination of this matter and, consequently, does not conflict with any decision of this Court or of any other Circuit Court of Appeals. Furthermore, the reversal of the Tax Court here brings the decision in harmony with previous decisions of the Tax Court where the relationship between Sections 22 (a) and 117 was in issue. *Maloy* v. *Commissioner,* 45 B. T. A. 1104; *Green* v. *Commissioner,* 7 T. C. 263; see also *Grey* v. *Commissioner,* 41 B. T. A. 234, affirmed, 118 F. 2d 153 (C. C. A. 7th).

There is no issue in this case concerning the proper interpretation of Section 162 (a) and the scope of the charitable deductions permitted there-

under. Consequently, *Old Colony Co.* v. *Commissioner,* 301 U. S. 379, and *Helvering* v. *Bliss,* 293 U. S. 144 (Pet. 8–9), dealing with the liberal construction to be given to the sections affording charitable deductions, are quite beside the point. Moreover, it is appropriate to observe that Congress has nowhere indicated an intention that a trust making a charitable contribution (or its taxable beneficiaries) should obtain an added tax windfall merely because, as here, the income of the trust is largely composed of capital gain.

3. The Circuit Court of Appeals was not precluded from reversing the Tax Court by *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231. The only issue on review concerned the proper construction of the statutory provisions discussed above. The determination of the Circuit Court of Appeals here, as in *Crane* v. *Commissioner,* 331 U. S. 1, 15, "* * * announced rules of general applicability on clear-cut questions of law." Accord: *Commissioner* v. *Wilcox,* 327 U. S. 404; *Trust of Bingham* v. *Commissioner,* 325 U. S. 365. Those cases plainly disprove the taxpayer's assertions (Pet. 10–13) that the Circuit Court of Appeals was without authority to reverse the Tax Court.

CONCLUSION

The decision of the Circuit Court of Appeals is correct. No conflict in decisions is presented

for resolution by this Court. Accordingly, further review of the case is not warranted.

Respectfully submitted.

PHILIP B. PERLMAN,
Solicitor General.
THERON LAMAR CAUDLE,
Assistant Attorney General.
HELEN R. CARLOSS,
HILBERT P. ZARKY,
Special Assistants to the Attorney General.

NOVEMBER 1947.

APPENDIX

Internal Revenue Code:

SEC. 21. NET INCOME.

(a) *Definition.*—"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

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(26 U. S. C. 1940 ed., Sec. 21.)

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

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(26 U. S. C. 1940 ed., Sec. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions:

* * * * *

(g) *Capital Losses.*—

(1) *Limitation.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117. (26 U. S. C. 1940 ed., Sec. 23.)

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SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter.

* * * * *

(2) *Short-Term Capital Gain.* — The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than 18 months, if and to the extent such gain is taken into account in computing net income;

(3) *Short-Term Capital Loss.*—The term "short-term capital loss" means loss from the sale or exchange of a capital asset held for not more than 18 months, if and to the extent such loss is taken into account in computing net income;

(4) *Long-Term Capital Gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing net income;

(5) *Long-Term Capital Loss.*—The term "long-term capital loss" means loss from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such loss is taken into account in computing net income;

(6) *Net Short-Term Capital Gain.*—The term "net short-term capital gain" means the excess of short-term capital gains for the taxable year over the sum of (A) short-term capital losses for the taxable year, plus (B) the net short-term capital loss of the preceding taxable year (if beginning after December 31, 1937), to the extent brought forward to the taxable year under subsection (e);

(7) *Net Short-Term Capital Loss.*—The term "net short-term capital loss" means the excess of short-term capital losses for the taxable year over the short-term capital gains for such year;

(8) *Net Long-Term Capital Gain.*—The term "net long-term capital gain" means the excess of long-term capital gains for the taxable year over the long-term capital losses for such year;

(9) *Net Long-Term Capital Loss.*—The term "net long-term capital loss" means the excess of long-term capital losses for the taxable year over the long-term capital gains for such year.

(b) *Percentage Taken Into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 percentum if the capital asset has been held for not more than 18 months;

$66\frac{2}{3}$ per centum if the capital asset has been held for more than 18 months but not for more than 24 months;

50 per centum if the capital asset has been held for more than 24 months.

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(26 U. S. C., 1940 ed., Sec. 117.)

SEC. 161. IMPOSITION OF TAX.

(a) *Application of Tax.*—The taxes imposed by this chapter upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

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(b) *Computation and Payment.*—The tax shall be computed upon the net income

of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor).

* * * * *

(26 U. S. C., 1940 ed., Sec. 161.)

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23 (o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23 (o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether

distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

* * * * *

(26 U. S. C. 1940 ed., Sec. 162.)

Treasury Regulations 103, promuglated under the Internal Revenue Code:

SEC. 19.162–1. *Income of estates and trusts.*—* * *

From the gross income of the estate or trust there are also deductible (either in lieu of, or in addition to, the deductions referred to in the preceding paragraph of this section) the following:

(1) Any part of the gross income of the estate or trust for its taxable year which, by the terms of the will or of the instrument creating the trust, is paid or permanently set aside during such year for the charitable, etc., uses or purposes referred to or described in section 162 (a). This deduction is in lieu of that authorized by section 23 (o) in the case of individual taxpayers.

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